

In the United States
Circuit Court of Appeals
For the Ninth Circuit.

The Republic Supply Company of
California, a corporation,

Complainant,

vs.

Richfield Oil Company of California,
a corporation,

Defendant.

Security-First National Bank of Los
Angeles, as Trustee, et al.,

Appellants and Cross-Appellees,

vs.

Universal Consolidated Oil Company,
a California corporation,

*Intervenor, Appellee and
Cross-Appellant,*

The Chase National Bank of the City
of New York, et al.,

Appellees.

BRIEF OF CROSS-APPELLANT UNIVERSAL
CONSOLIDATED OIL COMPANY.

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BRIEF OF CROSS-APPELLANT UNIVERSAL
CONSOLIDATED OIL COMPANY.

PRELIMINARY STATEMENT.

This proceeding to establish a prior lien upon certain assets in the hands of William C. McDuffie, as Receiver of the Richfield Oil Company of California,* was brought by Universal Consolidated Oil Company by means of a bill in intervention against said Receiver and the Security-First National Bank of Los Angeles, as Trustee, under the terms of the mortgage and trust indenture of Richfield dated May 1, 1929. The theory of the action is that Richfield, after acquiring control of the Board of Directors of Universal shortly prior to going into receivership, took and misappropriated \$1,625,000 of cash belonging to the latter company, without the knowledge or approval of Universal, and deposited same in Richfield's bank account with the Security Bank. These funds in part were subsequently invested by Richfield in certain assets which have passed into the hands of the Receiver, and which assets Universal claims are now held in trust for it. [Tr. pp. 67 to 82, incl.]

Answers of the Receiver and the Security Bank to said bill in intervention were duly filed, which answers in the main consisted of denials of the material allegations of the bill in intervention. [Tr. pp. 83 to 95, incl.]

The bill in intervention, together with the issues raised thereto by the answers, was referred for hearing to a Special Master, William A. Bowen, Esq., appointed by the District Court. [Tr. p. 64.] The matter was heard upon oral and documentary evidence, and thereafter the

*In this brief William C. McDuffie is referred to as Receiver; Richfield Oil Company of California is referred to as Richfield; Universal Consolidated Oil Company is referred to as Universal, and Security-First National Bank of Los Angeles is referred to as Security Bank. (All italics are ours unless otherwise noted.)

Special Master sustained Universal's contention that the transaction whereby the money was taken from Universal by Richfield was an actual misappropriation of funds by one standing in a fiduciary capacity, and was not, as contended by defendants, a bona fide loan; and found that the result of those misappropriations was to constitute Richfield a trustee for Universal, and the funds taken trust funds. He also found that Universal had succeeded in tracing its trust funds into specific parcels of property that passed into the hands of the Receiver, and that Universal was therefore entitled to prior liens upon those specified parcels in the hands of the Receiver in the total amount of \$403,993.92. Universal was awarded an unsecured claim in the amount of \$779,154.31, being the balance of the misappropriated money which it was held had not been sufficiently traced into specific property in the possession of Receiver. [Tr. pp. 109-110; 172; 205-206.] These findings of the Special Master were approved by the District Court in its decree, from which this appeal was taken. [Tr. pp. 42 to 44, incl.]

In this appeal Universal claims that it should have been awarded prior liens in an amount totaling \$849,864.25—it being claimed that Universal traced this amount of its money into specific property now in the possession of the Receiver. The difference in the amount awarded Universal by the Court and Special Master (\$403,993.92) and the amount which Universal claims it should have been awarded (\$849,864.25), arises entirely from the erroneous method adopted in determining the lowest bank balances reached by the account of Richfield in the Security Bank. In that account Richfield deposited the funds taken from Universal and there commingled them with its own funds. If the Court and Special Master

were incorrect in the method employed by them in determining these bank balances, then Universal is entitled to liens in excess of the ones actually awarded it. This brief will be devoted entirely to a discussion of that one question, and, necessarily, it is assumed in this brief that all other points were correctly decided in favor of Universal.

STATEMENT OF THE CASE.

While one of the issues before the Special Master was the question of whether or not the financial transactions between Universal and Richfield gave rise to a trust relation—and the report of the Special Master thereon is in the affirmative—it has now been conceded by all parties that the taking of Universal funds was a misappropriation resulting in making Richfield the trustee of a constructive trust for Universal, as beneficiary. [Tr. p. 97.] As a result of this stipulation, it becomes unnecessary to present in detail the numerous schemes, machinations and financial trickery practiced by Richfield upon Universal. However, we believe it advisable to give a short history of the transactions by which Richfield acquired control of Universal, and misappropriated \$1,625,000.00 from that company.

Universal was a small, independent oil company engaged in the business of producing oil in California, but not owning any refineries, pipelines or marketing business. Universal's stock was owned by the general public, the control, however, being vested in William H. Crocker. [Tr. p. 118.]

In the summer of 1929 Universal had accumulated about \$1,700,000.00 in excess cash. Most of this money had been placed in the call loan market. This large sum

of ready cash was the magnet which drew the attention of the Richfield's "financiers." In discussions between the various men in control of Richfield, the cash which Universal had on hand was favorably commented upon, and the fact was also mentioned that if Richfield acquired control of Universal, it could advance some of that cash to itself. [Tr. p. 118.] From that time on the rape of Universal was quickly planned and consummated.

It was planned that Joe Toplitzky, a Director of Richfield, and one of its dominant factors, should form a syndicate and get control of Universal by contracting to purchase the Crocker holdings (167,000 shares). On August 13, 1929, a contract was made by Toplitzky to acquire the Crocker stock, the contract giving Toplitzky the right to nominate a majority of the Board of Directors of Universal immediately. [Tr. p. 119.] Richfield was to buy 47,000 shares of this stock, which it did on September 27, 1929. Three days later Talbot, Chairman of Richfield's Board of Directors, went in as President and Director of Universal; and Fuller, President of Richfield, Tucker, a Director of Richfield, and Melvin, Vice President and General Counsel of Richfield, went on the Board of Directors of Universal. From then on Richfield controlled and dominated Universal [Tr. p. 121], although Richfield's stock interest in Universal only amounted at that time to 13 per cent of the outstanding shares. Ultimately Richfield's holdings in Universal were increased to 52 per cent. [Tr. p. 120.]

Immediately after getting control of the Board of Directors and executive offices of Universal, Richfield men were placed in all responsible positions in the corporation, and employees of Richfield were given authority to sign Universal checks. [Tr. pp. 121 and 122.]

Beginning with October of 1929, Universal, under the domination of Richfield, and at the direction of Talbot, recalled its surplus cash of \$1,700,000.00 from the call loan market and from another loan that had been made. The monies were placed in depositories selected by Talbot. [Tr. p. 125.] Then started the raid on Universal. [Tr. p. 126.]

On November 13, 1929, Richfield took \$750,000.00 of Universal's available cash. Other withdrawals occurred periodically from that day forward until all of Universal's excess cash was gone. [Tr. p. 126.] The policy of withdrawing Universal funds from the call loan market and thereafter turning Universal funds over to Richfield was determined by Talbot (Chairman of the Board of Richfield), and Talbot's orders were carried into execution under the supervision of McKee (Assistant to Talbot in the Richfield organization). [Tr. p. 125.]

All of these withdrawals were by checks payable to Richfield, which checks were deposited by Richfield in its general bank account in the Security Bank at Los Angeles.

No note was ever given to Universal by Richfield for any of the moneys represented by the aforesaid checks of Universal, nor was any security given in connection therewith. [Tr. p. 127.] No resolution was ever adopted by the Universal Board of Directors authorizing or ratifying the taking of the funds by Richfield, nor is there any resolution in the minutes of Universal from September 30, 1929, to the time of the appointment of the Richfield Receiver on January 15, 1931, authorizing any loans to Richfield or authorizing any officer of Universal or anyone else to loan any of the Universal money to anybody. [Tr. p. 127.]

None of the directors other than those connected with Richfield were ever advised of the taking of these monies, nor were the takings ever disclosed to the stockholders of Universal, despite efforts made by individual stockholders to secure information as to the financial position of the company. In fact, Richfield and its officers did everything possible to conceal the facts of the misappropriation from everyone other than those connected with the Richfield organization. No mention of the takings appeared in the annual report to the stockholders of Universal issued over the signature of Talbot. [Tr. pp. 136 to 139, incl.]

When a stockholders' meeting of Universal was to be held on April 15, 1930, it became apparent to the Richfield management that the cash position of Universal would have to be bolstered in order to avoid questions from minority stockholders. To conceal the circumstances surrounding these misappropriations, Richfield, prior to the meeting and on the morning of April 15, 1930, deposited in Universal's bank account, \$600,000.00 so that the cash on hand would approximate the sum shown in the annual report. As soon as the stockholders' meeting was over the \$600,000.00 was returned to Richfield. [Tr. pp. 135, 136.]

By the shifting of these funds from Richfield to the Universal account, and back again when the necessity was gone; by concealment of the transfers, and by false financial statements, Richfield was able to perpetrate and conceal, until the receivership, this misappropriation of Universal funds.

Many other details of this financial juggling are set forth in the Master's Report. [Tr. pp. 118 to 142. incl.]

We now turn to the evidence that was introduced for the purpose of tracing the money that was misappropriated by Richfield into the bank account of that corporation, and from there into various properties which were purchased and paid for in whole or in part by funds from that account.

All the facts in regard to the actual deposit of Universal's monies and actual withdrawals of the commingled funds are agreed upon. It is admitted that this money was in Universal's bank accounts, and that it was drawn out on Universal checks payable to Richfield on the following dates and in the amounts set forth:

Date	Amount
Nov. 13, 1929	\$350,000.00
Nov. 13, 1929	400,000.00
Jan. 20, 1930	200,000.00
Feb. 15, 1930	250,000.00
Feb. 15, 1930	250,000.00
Feb. 25, 1930	100,000.00
Feb. 27, 1930	100,000.00
June 6, 1930	75,000.00

[Tr. p. 126.]

Two days after February 15, 1930, Richfield returned \$100,000.00 of this money to Universal. [Tr. p. 126.]

As before noted, all of the money misappropriated by Richfield from Universal went into a checking account maintained by Richfield in the Security Bank, and this trust money was commingled with other funds belonging to Richfield in that account. [Tr. pp. 97, 98.]

At the close of business on January 8, 1931, which was a week before the appointment of the Receiver, Richfield

had entirely used up the funds in this commingled account, and on that date there existed for the first time an overdraft of \$18,080.18. Consequently Universal cannot go beyond this date in its tracing. [Tr. p. 98.]

All of the property and assets here involved, including the additional property which Universal claims was purchased with trust funds, were paid for by checks issued out of this commingled bank account maintained by Richfield. The amounts of these checks, the dates on which they passed through the Security Bank, and the property that they paid for, all appear in columns 1 and 3 of Appendix A attached to this brief, and are also set forth in Schedule A on page 102 of the transcript. [Tr. pp. 102-105, columns 1 and 6.]

Since the monies used by Richfield that belonged to Universal were trust funds, and since such money was traced into the Richfield commingled bank account, and since with such commingled funds Richfield purchased various assets on which a trust was impressed by the Special Master, the problem on this phase of the case deals with the question of the method used in tracing the trust funds. Universal, in tracing its funds, was of course limited in such tracing to the lowest intermediate balance that existed in the Richfield bank account at the time of the purchase of these particular assets.

(a) THE METHOD OF COMPUTING LOW BALANCES
ADOPTED BY THE SPECIAL MASTER.

The Special Master has detailed the various steps by which the funds were traced by Universal into the property purchased by Richfield. This method may be summarized as follows:

After the first deposit of the trust money, the lowest bank balance was ascertained between the time of this deposit and the first payment on property from the commingled bank account. Thereupon a trust was enforced upon the property for the amount of the payment, but the amount of the trust lien was limited to whichever one of the following sums was the lower; the said lowest bank balance or the said first deposit. If this purchase of the first piece of property did not exhaust the amount of the first deposit, then the trust was to be continued as to the unexhausted balance on subsequent purchases of property. If the trust amount was not entirely consumed by the applications on these purchases of property then the balance of said first deposit, limited by the lowest balance, would be carried over as a credit to Universal to the time of the second deposit of Universal funds. [Tr. pp. 145 to 147, incl.]

The practical application of the foregoing method will, we believe, be clarified by an illustration:

Suppose, for example, that Richfield, on February 1st, had deposited in its account in the Security Bank \$2,000.00 which it held in trust for Universal. At that time its bank balance in the Security Bank was \$3,000.00. Between that date and February 3rd, the balance always remained above \$2,000.00, but Richfield paid out no money for specific properties. On February 3rd the balance of Richfield's account in the Security Bank fell to \$1,000.00, but never fell below \$1,000.00. The balance was subsequently increased by additional deposits of Richfield funds, and on February 6th Richfield purchased a parcel of property for \$750.00. On February 7th purchased another parcel of property for \$750.00, or a total of \$1500.00 for the two pieces. Applying the foregoing method, we

see that Universal's right to trace its funds into the specific parcels of property is limited by the \$1,000.00 low balance reached by the Richfield account on February 3rd. It is entitled to a lien for the sum of \$750.00 upon the parcel purchased on February 6th. However, its lien upon the parcel purchased on February 7th is limited to \$250.00, as that is the balance of Universal funds remaining in the Richfield account.

If we change the facts slightly, and assume that the second parcel of property purchased on February 7th cost but \$150.00, then Universal would have a lien on the parcel purchased February 6th to the amount of \$750.00, and on the parcel purchased February 7th to the amount of \$150.00. This would leave Universal with a balance of \$100.00 unexpended for property which would be carried over to the next deposit of Universal's funds, assuming, of course, that the low balance thereafter in the account and up to the time of the next deposit was not less than \$100.00.

The crucial question here involved is the proper method of determining this lowest balance. Three different methods might be used in making the calculations. These are set forth by the Special Master in his report [Tr. p. 147], and are briefly as follows:

1. By taking the lowest daily closing balance on the bank's record. This figure was arrived at by taking the opening balance of the same day, adding thereto all deposits on that day, and charging against the total all the

withdrawals for the day. This classification appears in column 3 of Schedule A. [Tr. p. 102.]

2. By taking the lowest posted balance on the books of the bank on a particular date. This is determined by taking the opening balances of the day and by adding thereto such deposits and deducting such withdrawals as were posted by the bank's bookkeeper at that particular time of the day. This method appears in column 4, Schedule A. [Tr. p. 102.]

3. By taking the opening balance of the particular day, deducting therefrom all of the withdrawals made on that day, and *without* crediting to the account any deposits of the day. This method appears in column 5 of Schedule A [Tr. p. 102], and is the one used by the Special Master in determining the low balances.

It is the contention of Universal that the Special Master should have used the lowest daily closing balances (No. 1 *supra*) in order to determine the correct amount of Universal's trust lien, or, *at least*, the Special Master should have used the lowest daily posted balances, (No. 2 *supra*).

Had the Special Master used the lowest posted balances (No. 2, *supra*), the trust liens awarded to Universal would have been the sum of \$664,241.54; and had the Special Master adopted the lowest daily closing balances (No. 1, *supra*), the amount awarded to Universal would have totaled \$849,864.25.

For the convenience of the court we have set forth in Appendix A, attached to this brief, a tabulation showing the amounts of the liens under each of the three methods hereinbefore discussed.

ASSIGNMENTS OF ERRORS RELIED ON BY APPELLANT.

District Court erred in approving and confirming finding of fact and/or conclusion of law of the Special Master that said intervenor was entitled only to the interest imposed upon certain designated parcels, to-wit: Parcels 1 to 8, inclusive, in the total sum of \$403,993.92. [Assignment of Errors 2, 4; Tr. pp. 266, 267.]

District Court erred in approving and confirming finding of fact and/or conclusion of law of said Special Master limiting the recovery of Universal to the pro rata balance theory adopted by said Special Master. [Assignment of Errors 6, 9, 11; Tr. pp. 268, 269.]

District Court erred in failing to decree and award in favor of Universal a trust on Parcels 1 to 9, in the aggregate amount of \$849,864.25. [Assignment of Errors 5, 12, 13; Tr. pp. 268, 270, 271.]

District Court erred in failing to allow interest at the rate of 6% per annum based upon the closing bank balance in the account of Richfield. [Assignment of Errors 7, 8, 10, 11; Tr. pp. 268, 269.]

SUMMARY OF ARGUMENT.

It is our purpose to show, first, that the lowest daily closing balances were the proper balances to be used in determining the amount of the trust lien awarded Universal; secondly, that the lowest daily posted balances should have been used as a very minimum in determining the amount of the trust lien awarded Universal; and, thirdly, that the lowest daily closing balances were the proper balances to be used in determining the amount of the trust lien awarded Universal.

ARGUMENT.

I.

The Closing Balances on a Particular Date Should Have Been Used by the Special Master in Determining the Amount of the Trust Lien.

Since the stipulation of the parties in this appeal proves the misappropriation of funds, and proves that Richfield was made the trustee thereof; since the monies so misappropriated went into the Richfield bank account; since Richfield purchased certain properties with checks on this commingled bank account between the date of the first deposit of misappropriated funds and the depletion of the account, there is no question but that Universal is entitled to a trust lien on the properties purchased, governed solely by the lowest intermediate balances in the bank account.

These underlying principles have been announced in the leading cases of *Knatchbull v. Hallett*, 13 Ch. Div. 696 (1879), and *In re Oatway*, L. R. (1903), 2 Ch. Div. 356, which cases have been approved time after time in our Federal courts.

In re Pacat Finance Corp., 27 Fed. (2d) 810 (C. C. A. 2nd);

Brennan v. Tillinghast, 201 Fed. 609 (C. C. A. 6th);

Primeau v. Granfield, 184 Fed. 480 (D. Ct. N. Y.).

See, also:

Note in 82 A. L. R. 46.

In determining the amount of these bank balances the Special Master used the method which cut down the

y Universal to the lowest possible point—the
t unfavorable to Universal. The Special Mas-
king out his method, took the amount of money
k account on the morning of a particular day,
ed therefrom all of the withdrawals of that
without giving credit to the deposits made on that
ile this method has done partial equity to the
Universal, yet it has not done complete equity.
as insured Richfield, the wrondoer, against any
recovery, yet this has been accomplished at the
Universal, the innocent party.

s method of computation is manifestly unfair
al is evident at first blush, for it presumes that
withdrawals of the day were made *prior* to any
osits of that day. Such method is as unreason-
the converse method were used, namely, that
deposits of the day were added to the opening
hout deducting the withdrawals therefrom.

be remembered that the only balance, which is
to be a *true* bank balance, is the balance at the
day when all withdrawals have been charged
account and all deposits have been credited to
t. Since, in ordinary business practices, the
ances of the day are accepted as the proper
f determining balances, and since they are the
balances, it seems self-evident that these bal-
ld be used.

not unmindful of the statement of the Circuit
ne case of *In re Brown*, 193 Fed. 24 (C. C. A.
ne effect that opening and closing balances were
nt in that case, as there might have been with-
ring the day that would have completely wiped

out the balance. But that case involved quite a few claimants, who were in an identical position, so that a recovery by one defrauded person affected the recovery of others who were defrauded in like manner. In the instant case, no other person is in the position of Universal; and no equity is present that is equal to or higher than Universal's.

Furthermore, in the *Brown* case, 193 Fed. 24, the facts showed that a certification of a check in a large amount completely depleted the account—thereby dissipating all claims to any trust funds, even if they were in the account. No question of certification is present in the instant case.

It must also be noted that the Circuit Court in that case takes cognizance of deposits in the account, saying:

“It might very well be that on any one day checks were presented which exhausted the morning balance *and its accretions*, in which event these moneys would have been dissipated.” (193 F. 26.)

Such reference to accretions could only mean deposits, as it is difficult to understand how else the account could be augmented.

We note that the Supreme Court, in passing on the case of *Schuyler v. Littlefield*, 232 U. S. 707, 58 L. Ed. 806 (a companion case to *In re Brown, supra*), mentions the condition of the account at the close of a particular day:

“If the trust fund of \$9,600.00 was included in the check for \$266,600.00, then it was dissipated except to the extent of \$6,180.17, which was the sum left to Brown & Company's credit at the *close of business* on August 24th. And inasmuch as all of

balance was paid out early the next day, the fund was thereby wholly dissipated so far as the bank account was concerned." (58 L. Ed. 808.)

The presumption prevails when Richfield withdrew from the commingled account and dissipated same, that the dissipated funds were from Richfield's own pocket and not from the trust funds. *National Bank v. Williams*, 104 U. S. 54, 26 L. Ed. 693. Logically, the force of the same presumption, the amount of the withdrawals should be charged against the amount of the deposits on a particular date. The withdrawals thus made must be first offset against the deposits of the same date. The principle of equity in this case would warrant the Master in utterly disregarding the deposits

in the case of *Horigan Realty Co. v. First National Bank*, 273 S. W. 773, there is involved a question of the commingling of certain funds in the account of the bank. Flynn was the secretary and treasurer of the plaintiff corporation and, in connection with the purchase of a piece of property owned by the plaintiff, Flynn deposited \$5,000.00 in Liberty bonds. These bonds were purchased by Flynn, but instead of the money going into the account of the plaintiff, Flynn deposited the amount in his personal account. Flynn was indebted to the bank on some notes, and shortly after the death of the plaintiff the bank charged the balance in the account, and the plaintiff paid these notes. The particular account involved, in addition to the deposit from the Liberty bonds, other

deposits and withdrawals. In speaking of this matter the court said:

“But we think the money, received from the sale of the bonds, and deposited by Flynn in the bank, may be traced and located in the hands of the bank at the date of Flynn’s death. Under like circumstances, it has been held that the depositor must be considered to have drawn out his own money in preference to the trust fund. *National Bank v. Insurance Co.*, 104 U. S. 54, 68, 26 L. Ed. 693. Applying this rule to the case at bar, we must presume Flynn first withdrew his own money from the bank before taking out any which belonged to the trust fund, and that *whatever deposits he made, after depositing the trust fund, were withdrawn before he drew upon the trust fund* or any part thereof which remained at the time of the withdrawals. Judgment was rendered by the court for the least amount that Flynn had to his credit between the time of the deposit of the trust fund and the time of his death. Under the rules above referred to, this was proper.” (p. 776.)

The case was reversed on other grounds.

Bearing in mind that every equity in this case should be in favor of Universal, and bearing in mind that the fraudulent practices of Richfield will only result in an unjust enrichment by the general creditors, at the expense of Universal, unless the trust is imposed to the maximum extent permitted by law, it is submitted that this court should adopt as the proper method of determining low balances the one founded on the closing bank balances. Even with all the aid afforded by this method, Universal will still not be able to recover its money one

cent, and Universal will still have a claim
 insured general creditor of close to \$300,000.00.

Amount of the liens to which Universal is entitled
 the lowest daily closing balances is as follows:

to Schedule A, Tr. p. 102, and applying the
 g balance to the first taking of Universal
 e: \$750,000, we find that the low occurred on
 3, 1929, when the account fell to \$272,704.61.

limits the amount of the lien to that amount
 a the following properties:

Property	\$ 50,000.00
ks, Rioco refinery	44,540.00
ion, Franklin and Vermont,	
eles	500.00
akee	35,421.75
Doheny)	
oheny)	
and marine facilities, Richmond)	
)	142,242.86
	<hr/>
Total	\$272,704.61

the next \$200,000 taken on January 20, 1930,
 ced into assets purchased by Richfield for the
 nces were always greater than this sum until
 February. Universal is then entitled to the
 liens:

amento distributing plant	\$ 500.00
res Universal stock, Delaney prop-	199,500.00
	<hr/>
Total	\$200,000.00

The liens resulting from the next takings are not quite as simple to explain because of the existence of successively lower balances on February 25, 1930, and on March 8, 1930. The closing balance of \$252,760.24 on February 25, 1930, limits the tracing of the \$500,000 taken in the ten days prior to that date to that sum. No property was purchased by Richfield between February 15th and February 25th. Another \$100,000 was taken by Richfield on February 27, 1930, so that thereafter \$352,760.24 could be traced into property bought. This was traced into some property paid for during the course of the next week, but a low balance of \$209,201.80 on March 8th served as a further limitation of the tracings. Summarizing the liens Universal would be entitled to during this period we find that they would be on the following property:

Watson refinery vapor recovery plant	\$34,332.84	
Rioco refinery storage tanks	48,000.00	
5100 shares Universal stock	10,625.00	92,957.84
	<hr/>	
Delaney property	50,000.00	
Service station, Franklin and Vermont, Los Angeles	7,500.00	
Watson refinery vapor recovery plant	34,332.43	
Rioco refinery storage tanks	50,000.00	
Delaney property	50,000.00	
Service station, Franklin and Vermont, Los Angeles	500.00	

Land, Sacramento distributing plant	4,500.00	
Watson refinery vapor recovery plant	12,369.37	209,201.80
	<hr/>	
Total		<hr/> \$302,159.64

The low balance at no time fell below the sum of \$75,000 taken on June 6, 1930. That sum is a lien on the following properties:

Watson refinery vapor plant	\$34,332.43
Rioco refinery storage tanks	40,667.57
	<hr/>
Total	\$75,000.00

Cumulatng the investments in the several properties, Universal is entitled to liens, based on the lowest daily closing balances, on the several properties for the following amounts:

Delaney producing property	\$150,000.00
Rioco refinery storage tanks	183,207.57
Watson refinery vapor recovery plant	115,367.07
106,000 shares of Universal stock, Certificates LX26, 27, 28, 32	199,500.00
5100 shares of Universal stock, Certificate LX31	10,625.00
Tanker Kekoskee	35,421.75
Service station, Franklin and Vermont, Los Angeles	8,500.00
Land, Sacramento distributing plant	5,000.00

Tanker Larry Doheny)	
Tanker Pat Doheny)	
Richmond marine terminal)	142,242.86
		<hr/>
Total		\$849,864.25

A full summary of all the data herein set out, together with dates, appears in Appendix A attached to this brief.

II.

If the Closing Balances Are Not Used, Then at Least the Lowest Posted Balances Should Be Used.

Without waiving our claim that the closing balances should be used, we now turn to a discussion of the effect of using the lowest posted balances. The nearest approach to a determination of the *exact* order in which deposits were made and checks were withdrawn appears in the lowest posted balances kept by the bank. While it was possible that at the time of the posting other checks might have been in the bank which had not been charged against the account, and other deposits might have been in the bank which had not been credited to the account, yet *no* evidence was produced by the Security Bank which showed these conditions to exist.

In the very nature of the present complexities of the banking business (unless the functions of the bank were stopped and time were taken out to make an exact balance), this is the only means that anyone can use to determine the balance of the account at any particular time of a day. This is the balance that the bank would quote to anyone inquiring what the balance of the account was at that particular moment.

According to the testimony, the books of the Security Bank are kept on bookkeeping machines. To enable them to keep up on their work the bookkeepers are not required to wait until the end of a day before they post checks to an account. Checks that come from the clearing house on the first clearing are given to them as soon as they are received, which is shortly after 8:15 in the morning. The same procedure is followed on the checks received in the second clearing, at 11:15 in the morning. [Tr. p. 99.]

Checks which come in over the counter are given to the bookkeepers periodically throughout the day, commencing at approximately 10:30 in the morning. Immediately upon receipt of the checks they are assorted by accounts and the task of posting them begins. Each time a group of checks or deposits, or both, is posted upon the ledger sheet of a particular account the bookkeeper, before he can remove the ledger sheet from the bookkeeping machine, must strike a balance for the account. While the bookkeepers are not required to follow any set rule and may post the checks in any order they desire, is it not logical to assume that checks are posted in approximately the order in which they are presented?

It is to be remembered that the Security Bank, in the course of a day's work, would post the balances in the Richfield account from three to eight times a day. [Tr. p. 99.] With this frequent number of postings, it is inconceivable that any large amount in checks, or any large amount in deposits would remain unposted at the bank for anything more than a very short fraction of the day. Nor, for that matter, is it conceivable that a

check presented or a deposit made toward the close of a day's business would appear on the books at the same time or ahead of checks presented to the bank at the time of the first morning clearing.

These posted balances, in the very nature of things, were as close to the true balances at the particular times as the Security Bank could make it. Unless the Security Bank can show that these posted balances were actually false, we submit that this court *must* accept the evidence and assume they were correct. It certainly is not enough for the Security Bank to come into court and attempt to impeach the records by saying they *might* have been incorrect. Particularly is this so when the very records are kept under the sole direction of the Security Bank. It should not be permitted to take advantage of the situation, and, at least, the burden would be on the Security Bank, rather than on Universal, at this stage of the proceedings to disprove the correctness of the posted balances.

In a headnote, written by the court, to the case of *Central National Bank v. Connecticut Mutual Life Insurance Co.*, 104 U. S. 54, 26 L. Ed. 693, it is there stated:

“That, so long as trust property can be traced and followed into other property into which it has been converted, the latter remains subject to the trust, and that if a man mixes trust funds with his own, the whole will be treated as the trust property, except so far as *he may be able to distinguish what is his own*, are established doctrines of equity and apply in every case of a trust relation, and to moneys deposited in a bank account, and the debt thereby created, as well as to every other description of property.” (Headnote 3.)

In the case of *American Surety Co. v. Jackson*, 24 Fed. (2d) 768 (C. C. A. 9), Judge Rudkin said:

“It will thus be seen that the rule itself rests largely on a legal fiction. But if there is a presumption that trust funds have not been wrongfully misapplied or criminally used by the officers of the bank, as held by this court in the Spokane County case, *supra*, and such a presumption no doubt obtains, it would seem to follow as a necessary corollary that *the burden was on the bank* or its successor in interest to prove that the trust funds or some part of them were in fact wrongfully misappropriated or criminally used by the bank. This presumption in nowise conflicts with the rule that in the end the claimant must trace the funds and establish his claim thereto by clear and satisfactory proof as against the receiver who represents all creditors.” (P. 770.)

Again, in *Meyers v. Baylor University*, 6 S. W. (2d) 393 (Tex.), the rule is thus given:

“It is quite true that the burden of proof was upon plaintiff to establish the trust, but, when proof of the fiduciary relationship of the parties was made, the betrayal of the trust, and probable amount of the embezzlement shown, a *prima facie* case was presented, and *the burden was then on Meyers to show*, if he could, that his money, and not that of the plaintiff, paid for the properties in whole or in part.

Meyers was in possession of the exact facts, and it was his duty to reveal the entire truth. As he did not testify, and made no explanation of this matter, every intendment is against him." (P. 394.)

See, also:

- Israel v. Woodruff*, 299 Fed. 454 (C. C. A. 2);
In re J. M. Acheson Co., 170 Fed. 427 (C. C. A. 9);
Smith v. Mottley, 150 Fed. 266 (C. C. A. 6);
Kineon v. Bonsall, 185 N. Y. S. 694; aff. 134 N. E. 598;
Spencer v. Pettit, 17 S. W. (2d) 1102 (Tex.).

In the absence of any direct and positive testimony that they were incorrect, it is the contention of this appellant that the posted balances appearing on the bank's books during the course of a day represent with reasonable certainty the fluctuations of that account during the day, and show with a sufficient degree of accuracy that the balance during the course of the day did not fall below the lowest of those fluctuations.

Further support is given to appellant's claim when the nature of the relationship between a bank and its depositor is considered. There is no dissent from the rule that that relationship is one of debtor and creditor.

See:

- New York National Bank v. Massey*, 192 U. S. 138, 48 L. Ed. 380;
Florence Mining Co. v. Brown, 124 U. S. 385, 31 L. Ed. 424;
Arnold v. San Ramon, 184 Cal. 632;
Bank of America v. Calif. Bk., 218 Cal. 261.

Consequently, when a deposit is made to an account and that deposit is placed on the bank's books to the credit of the depositor, that deposit becomes a fund owed by the bank to the depositor. Until such time as an offset is made against the account, that fund remains intact. It is not depleted until such time as a check is presented, paid, and *charged* against the account upon the books, for a check is not an assignment of the funds in a bank.

See:

Civil Code, Calif., Sec. 3265e;

Sneider v. Bank of Italy, 184 Cal. 595;

Guggenhim & Co. v. Lamantia, 207 Cal. 96;

Arnold v. San Ramon, 184 Cal. 632.

An examination of the procedure followed by the bank in connection with checks coming to it from the clearing house, which, of course, is the vehicle by which most checks come to a bank, must make it apparent that checks so delivered do not deplete the account of the depositor until such time as they are posted to his account. These checks are received from the clearing house at 8:15 and 11:15 in the morning. They need not be posted and paid, or refused, until 2:30 in the afternoon of the same day, although they are given to the bookkeepers immediately. Consequently, if a check for \$100 was presented at the window and paid during the course of a morning, payment on another \$100 check against the same account, which latter check came from the clearing house at 8:15, would be refused if the payment of the former check left insufficient funds to cover the payment of the second. [Tr. p. 101.] Obviously it could not be said

that the check which came into the bank first from the clearing house, but was not posted in the ledger, depleted the account of the depositor. For payment upon it was refused because of the fact that it was to be posted after a check presented at the window.

Another example to prove definitely that posting in the ledger, rather than time of presentment, is what determines whether the account is depleted, occurs in the case of two \$100 checks coming to the bank in the morning's clearing at a time when the account upon which they were drawn contained only \$100. Under those circumstances, payment might be refused on either check, but it is quite apparent that the one that would be accepted is the one posted first upon the ledger account of the depositor. [Tr. p. 100.] Thus we see that, except in the case of certified checks, with which we are not concerned at all in the instant case, the factor controlling the bank in its determination of whether or not there are sufficient funds in the bank to pay the checks drawn, is the posted balances of the ledger. Although there may be many checks upon the bookkeeper's desk awaiting posting, the order in which they are actually posted to the account determines which shall be paid and, consequently, determines whether or not the fund that goes to make up the depositor's account has actually been depleted.

It is thus apparent that the crucial moment in determining when the balance is affected would be at the time that the check was actually posted to the account. Until such posting, the check manifestly would bear no different relation to the balance in the bank account than would an unpaid demand note issued by Richfield to the Security Bank and payable to the latter. The bank is a creditor

of the depositor to the extent of the loan, while at the same time it is a debtor to the depositor to the extent of his deposit. Although the bank may demand payment of the loan at any time, and may deduct the amount of the loan from the depositor's account, one could hardly say that the depositor's account was depleted to the extent of the loan until such time as that offset was *actually* made upon the ledger.

This position is reinforced by the case of *In re Brown*, 193 Fed. Rep. 24, affirmed by the Supreme Court under the title of *First National Bank of Princeton v. Littlefield*, 226 U. S. 110. On page 27, the Circuit Court says:

“We are clearly of the opinion that when the question is as to the disposition of a fund in a bank account, *the time when certification is signed and noted by the bank is the significant time*; it is then that the credit items which make up the balance of account are segregated by the bank as against the obligation assumed by certification.” (193 Fed 27.)

See, also:

People v. Keller, 79 Cal. App. 612, 615, where it is said:

“The acceptance of the check by the Santa Ana Bank, the surrender of the instrument to it, the payment of the money to the forwarding bank and *the entry of the transaction upon the books* of the Santa Ana Bank constituted a segregation or separation of the amount of dollars expressed in the check from the general mass of money in the bank as the portion owing by it to appellant's principal.”

Modern banking practices have been recognized by the courts. In the case of *Schumacher v. Harriett*, (C. C. A. 4th, 1931), 52 Fed. (2nd) 817, it was stated:

“The duty of courts is to apply the principles of law and equity *to the conditions of our changing life*; and we have no doubt that in view of *modern banking practices*, the modern but well-settled doctrine of tracing trust funds is applicable to the situation here disclosed.” (Pages 820-21.)

That our statement that the minimum that the Special Master should have used was the lowest posted balances, and that the failure to use the lowest posted balances created a situation that was manifestly inequitable to Universal, we need but look at the computations shown on Schedule A. [Tr. p. 102.]

There, under date of November 19, 1929, the lowest posted balance and the lowest closing balance are each shown in excess of \$200,000.00, while the lowest balance adopted by the Special Master's theory approximates \$93,000.00. Had the Special Master used the lowest posted balances for that period, Universal would have been awarded liens practically *twice* the amount that was awarded by the Special Master, arising out of the first deposit of Universal funds on November 13, 1929. It is again interesting to note that under date of January 23, 1930, the lowest posted balance and the lowest daily closing balance are in the identical sum of \$466,764.36—both of which sums exceed by approximately \$130,000.00 the amount used by the Special Master at that date. Again on January 30, 1930, and on February 1, 1930, the lowest posted balances very closely approximate the lowest daily closing balances—both of which respective

amounts are far in excess of the amounts used by the Special Master under his computations.

While subsequent to February 1, 1930, there is a greater variance in the lowest posted balances, in that they are considerably less than the lowest daily closing balances, yet it is to be noted that the lowest posted balances almost invariably exceed the balances used by the Special Master.

The amount of the liens to which Universal is entitled by using the lowest posted balances is as follows:

Of the first \$750,000 taken from Universal a low balance of \$198,719.80 was reached on November 27th, 1929. Thus the liens of Universal resulting from the first taking are limited to this figure rather than the sum of \$272,704.61 which appears as the low closing balance.

Delaney Property	\$ 50,000.00
Storage Tanks, Rioco Refinery	44,540.00
Service Station, Franklin & Vermont, Los Angeles	500.00
S. S. Kekoskee	35,421.75
S. S. Larry Doheny)
S. S. Pat Doheny) 68,258.15
Terminal & Marine Facilities, Richmond Plant)	
	<hr/>
Total	\$198,719.90

No intermediate daily balance of less than \$200,000 appears for some time subsequent to the next taking so liens for the full \$200,000 may be established here in the same manner as under the theory previously discussed.

Land, Sacramento Distributing Plant	\$ 500.00
106,000 shares of Universal Stock) 199,500.00
Delaney Group)
	<hr/>
Total	\$200,000.00

It is again not quite as simple to explain the liens arising from the next group of takings under this theory, as was found in working out the liens under the daily closing balances, *supra*. We will concede, for the purpose of working out this theory, that the low balance of \$122,941.84 on February 25, 1930, occurred after the deposit of the Universal check of \$100,000 on the same day, as well as after the \$400,000 deposit on February 15th. Our recovery would then be limited to \$122,941.84 plus the \$100,000 deposited on February 27, 1930. After some expenditure on assets further limitations occurred as a result of low balances of \$113,324.49 on March 10, 1930, and of \$53,259.91 on March 18, 1930. Universal would then be entitled to trace its funds into the following assets and assert liens on the following property for the amounts listed:

Watson Refinery Vapor Recovery		
Plant	\$34,332.84	
Rioco Refinery, Storage Tanks....	48,000.00	
5100 shares of Universal Stock..	10,625.00	\$ 92,957.84
		<hr/>
Delaney Property		50,000.00
Service Station, Franklin and Vermont, Los Angeles	7,500.00	
Watson Refinery Vapor Recovery		
Plant	34,332.43	
Rioco Refinery Storage Tanks....	11,427.48	53,259.91
		<hr/>
Total		\$196,217.75

An intermediate daily low balance of \$69,303.89 on June 18, 1930, limits the recovery of the \$75,000.00 to that figure. The following liens result:

Watson Refinery Vapor Recovery Plant.....	\$34,332.43
Rioco Refinery Storage Tanks.....	34,971.46
	<hr/>
Total	\$69,303.89

Summarizing the total liens on each particular piece of property under the limitations of this theory we find Universal entitled to the following liens:

Delaney Property	\$100,000.00
Rioco Refinery Storage Tanks	138,938.94
Watson Refinery Vapor Recovery System.....	102,997.70
Tanker Kekoskee	35,421.75
106,000 shares of Universal Stock, Certifi- cates LX26, 27, 28, 32.....	199,500.00
5100 shares of Universal Stock, Certificate LX31	10,625.00
Service Station, Franklin and Vermont, Los Angeles	8,000.00
Land, Sacramento Distributing Plant.....	500.00
Tanker Larry Doheny)
Tanker Pat Doheny) 68,258.15
Richmond Marine Terminal)
	<hr/>
Total	\$664,241.54

with dates, likewise appears in Appendix A attached to
A full summary of all the data herein set out, together
this brief.

CONCLUSION.

It is respectfully submitted that in allocating to Universal liens upon the property purchased by Richfield, the Special Master erroneously used a method which did not do equity to Universal. The only true method of determining low balances was and is the daily closing balances, and this method should have been used, or at the very minimum, the lowest daily posted balances should have been used.

As was stated in the case of *Conqueror Trust Co. v. Fidelity & Deposit Co.* (C. C. A. 8th, 1933), 63 Fed. 2nd 833:

“This ‘minimum balance’ theory is of course merely a *mathematic means* of resolving a conflict of interest * * *.” (P. 840.)

There is nothing in the position taken by the Special Master that would commend itself to this court because the Special Master, disregarding the equitable rights of Universal, has adopted a minimum balance *below* which it is impossible to go. Such mathematical means so used by the Special Master penalizes an innocent party. It must not be overlooked that 52 per cent of any recovery in this action inures to the benefit of Richfield by virtue of its present ownership of 52 per cent of the outstanding stock of Universal.

Respectfully submitted,

A. L. WEIL,

LE ROY M. EDWARDS,

Attorneys for Appellant.

APPENDIX "A"

TABULATION SHOWING TAKINGS OF UNIVERSAL FUNDS BY RICHFIELD, ASSETS PURCHASED WITH COMMINGLED FUNDS, LOW BALANCES UNDER THREE THEORIES ADVANCED, AND AMOUNT TRACEABLE INTO EACH ASSET CLAIMED UNDER EACH THEORY

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Date	Deposit of Universal Money in Richfield Account	Amount Paid on Property Paid for from Commingled Fund	Lowest Daily Closing Balances Between Takings of Universal Funds	Liens Claimed for the Following Sums by Reason of Column 4	Lowest Posted Balances Shown on Bank's Books During Any Day Between Takings of Universal Funds	Liens Claimed for the Following Sums by Reason of Column 6	Lowest Balance Ascertained by Deducting All Checks Cleared Each Day Without Crediting Deposits Made During the Same Day	Liens Claimed for the Following Sums by Reason of Column 8
1929								
Nov 13	\$ 750 000.00							
" 19			\$272 704.61		\$209 198.80		\$ 93 635.65	Delaney group producing properties
" 29		\$ 50 000.00		\$ 50 000.00		\$ 50 000.00		
" 30		44 540.00		44 540.00		44 540.00		
" 30		500.00		500.00		500.00		43 635.65
Dec 9		35 421.75		35 421.75		35 421.75		=====
" 23		164 746.20						
" 23		168 663.06		142 242.86		68 258.15		
" 23		190 914.94						
" 24								
" 31		49 385.00					76 032.84 (red)	Rioco refinery storage tanks, Hynes, Calif.
1930								
Jan 3		500.00						Service station at Franklin and Vermont, Los Angeles
" 3		50 000.00						Delaney group producing properties
" 11		15 825.00						Richville camp site, Backus property, Long Beach, Calif.
" 20	200 000.00		466 764.36		466 764.36		336 646.20	
" 23							308 662.67	
" 24		500.00		500.00		500.00		500.00
" 27		221 202.08						Land, Sacramento distributing plant, Sacramento, Calif.
" 29								106,000 shares capital stock Universal Consolidated Oil Company, certificates LX 26, 27, 28, 32
" 29		50 000.00						=====
" 30		53 680.00						Delaney group producing properties
" 30		500.00	464 148.47		462 088.47			Rioco refinery storage tanks, Hynes, Calif.
Feb 1			447 704.86		443 916.47			Service station at Franklin and Vermont, Los Angeles
" 15	500 000.00	(red)			172 136.10	(red)	222 642.41 (red)	
" 17	100 000.00							
" 24			296 779.62		20 925.52		20 879.26	
" 25	100 000.00		252 760.24		122 941.84		128 412.10 (red)	
" 26					204 138.29		204 138.29	
" 27	100 000.00				204 342.03		272 948.76	
Mar 1		34 332.84		34 332.84		34 332.84		34 332.84
" 1		48 000.00		48 000.00		48 000.00		48 000.00
" 4							239 919.57	
" 5		10 625.00		10 625.00		10 625.00	203 185.63	10 625.00
" 6								=====
" 8			209 201.80				17 400.43	
" 10								
" 12		50 000.00		50 000.00		50 000.00		17 400.43
" 18								=====
" 22		7 500.00		7 500.00		7 500.00		Service station at Franklin and Vermont, Los Angeles
" 25		34 332.43		34 332.43		34 332.43		Watson refinery vapor recovery plant, Los Angeles County, Calif.
" 28		50 000.00		50 000.00		11 427.48		Rioco refinery storage tanks, Hynes, Calif.
Apr 2		50 000.00		50 000.00				Delaney group producing properties
" 3		500.00		500.00				Service station at Franklin and Vermont, Los Angeles
" 7		4 500.00		4 500.00				Land, Sacramento distributing plant, Sacramento, Calif.
" 16							8 520.06	
" 21		34 332.43		12 369.37				Watson refinery vapor recovery plant, Los Angeles County, Calif.
" 26		50 000.00						Delaney group producing properties
" 28		50 000.00						Rioco refinery storage tanks, Hynes, Calif.
May 1	\$	500.00						Service station at Franklin and Vermont, Los Angeles
" 1		825.00						400 Shares capital stock Univ. Cons. Oil Co., cert. # LX 34
" 1		208.33						100 do LX 34
" 2		208.33						100 do LX 34
" 3		416.67						200 do LX 34
" 3		156.25						75 do LX 34
" 5		825.00	\$140 878.03					400 do LX 34
" 6		41.67						20 do LX 34
" 8		41.67						20 do LX 34
" 9		104.17						50 do LX 34
" 9		500.00						Delaney group producing properties
" 12		104.17						50 shares capital stock Univ. Cons. Oil Co., cert. # LX 34
" 12		5 083.33						2,440 do LX 38
" 15		3 125.00						1,500 do LX 36
" 19		1 600.00						Land, Sacramento distributing plant, Sacramento, Calif.
" 19		4 375.00						2,100 shares capital stock Univ. Cons. Oil Co., cert. # LX 40
" 20		583.33						280 do LX 38
" 20		3 541.67						1,700 do LX 39
" 21		20 000.00						Land adjacent Rioco refinery, Hynes, Calif.
" 23		34 332.43						Watson refinery vapor recovery plant, Los Angeles County, Calif.
" 26							\$ 73 096.23 (red)	
" 27		2 083.33						1,000 shares capital stock Univ. Cons. Oil Co., cert. # L3020
" 27		16 781.25						8,055 do LX 42
" 28		7 172.92						3,443 do LX 43
Jun 2		500.00						Service station at Franklin and Vermont, Los Angeles
" 4		50 000.00						Delaney group producing properties
" 6	\$ 75 000.00						114 164.03 (red)	
" 7			168 222.42		\$ 69 303.89			
" 18							122 078.81 (red)	
" 21						\$ 34 332.43		
" 25		34 332.43		\$ 34 332.43		45 336.49		Watson refinery vapor recovery plant, Los Angeles County, Calif.
" 27								
" 28		55 700.19		40 667.57		34 971.46		Rioco refinery storage tanks, Hynes, Calif.
Jul 14							1 679 420.83 (red)	
" 15		34 332.43						Watson refinery vapor recovery plant, Los Angeles County, Calif.
" 17		50 000.00						Delaney group producing property
" 31		500.00						Service station at Franklin and Vermont, Los Angeles
	\$ 1 625 000.00			\$849 864.25		\$664 241.54		\$403 993.92

STATEMENT OF ACCOUNTS
 SHOWING THE BALANCE OF THE ACCOUNT AS OF
 THE 31st DAY OF DECEMBER 1902

NO.	DATE	DESCRIPTION	DEBIT	CREDIT	BALANCE
		Balance forward			100.00
	1902	Jan 1			
		Jan 15	50.00		50.00
		Feb 1		25.00	25.00
		Mar 1	75.00		50.00
		Apr 1		30.00	20.00
		May 1	100.00		120.00
		Jun 1		40.00	80.00
		Jul 1	60.00		20.00
		Aug 1		50.00	70.00
		Sep 1	80.00		10.00
		Oct 1		60.00	70.00
		Nov 1	90.00		20.00
		Dec 1		70.00	90.00
		Dec 31			90.00
		Total	500.00	500.00	